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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the	)	
Cable Television Consumer	)	MM Dkt. No. 92-266
Protection and Competition Act	)	
of 1992	)	
	)	
Rate Regulation	)	

REPLY COMMENTS OF THE JOINT PARTIES ON THE FURTHER NOTICE OF PROPOSED RULEMAKING

Cablevision Industries, Inc., Cox Communications, Inc. and Jones Intercable, Inc. (the "Joint Parties"), by their attorneys, hereby submit their reply comments in the above-referenced proceeding.[1/] The Further Notice proposed to redefine the term "effective competition" for the purposes of calculating rate benchmarks by excluding systems that have 30 percent or lower penetration from the calculations. There is, however, no statutory basis for such an exclusion and, as was shown in the comments, the Commission is required to give weight to all the factors identified in the statute. For these reasons, the Commission may not exclude from its study systems that are subject to effective competition and that have 30 percent or lower penetration.

1/ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Report and Order and Further Notice of Proposed Rulemaking, MM Dkt. No. 92-266, FCC 93-177 (released May 3, 1993) (the "Further Notice").

I. The Commission Cannot Ignore "Low-Penetration" Cable Systems in Evaluating Rates for Systems Subject to Effective Competition.

The Joint Parties argue that the Commission does not have the power to use different definitions of the term "effective competition"—one for determining what cable systems are subject to rate regulation and another for determining what rates are reasonable. Although proponents of the dual meaning theory argue that the Commission should have this power, their goals are irrelevant: it is the statutory language that controls.

The statute, Section 623(*l*), defines terms "as used in this section."[2/] "Effective competition" is defined to encompass any cable system (1) with less than 30 percent penetration in its franchise area; (2) with competition from other multichannel video providers covering at least half the households in the franchise area and with at least fifteen percent penetration; or (3) with competition from the franchising authority in an area covering at least half of the households in the franchise area.[3/] Section 623(*l*) applies this definition to all of Section 623, including the subsection that governs regulatory jurisdiction and the subsections that govern the design of the regulatory scheme.

Because "effective competition" has been defined by Congress, the Commission has no power to alter the definition. A similar attempt to redefine the term "basic service" as used in the Cable Communications Policy Act of 1984 was rejected by the

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2/ 47 U.S.C. § 543(*l*).

3/ 47 U.S.C. § 543(*l*)(1).

Court of Appeals, notwithstanding the Commission's analysis of the legislative history of the statute, because the statute itself was unambiguous.[4/]

The response of cable opponents to this clear statutory mandate is to suggest that Congress would have written the statute differently if it had known what the Commission now knows.[5/] This is irrelevant, and speculation about what action Congress might have taken is superfluous.

Here, the statutory language leaves no doubt that the definition of "effective competition" applies to all parts of Section 623. Additionally, as is evident from the comments, excluding low-penetration systems would compound significant flaws in the underlying methodology of the Commission's rate survey calculations.[6/] An evaluation of the survey data does not lead to the conclusion that low-penetration systems should be excluded from the survey.

The telephone companies make a more sophisticated attempt to rewrite the statute. They argue that the Commission has power to give differing weight to each of the statutory factors used to set rates. This power, according to the telephone companies, implicitly affords the Commission the discretion to give differing weights to each of the elements of one of those factors. They claim that the Commission therefore

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4/ American Civil Liberties Union v. F.C.C., 823 F.2d 1554, 1567 (D.C. Cir.) cert. denied 485 U.S. 959 (1987) (holding that the Commission is not empowered to adopt "a definition of a particular term that is at odds with a definition of that very term contained in the Act itself") ("ACLU"). The National Cable Television Association ("NCTA") provides a detailed analysis of the applicability of the ACLU case in its comments. See Comments of NCTA at 7-9.

5/ See, e.g., Comments of Consumer Federation of America "CFA") at 3; see also Comments of National Association of Telecommunications Officers and Advisors, et al. at 6-7 (discussing Congressional "intent").

6/ See infra Part II.

can essentially ignore parts of the definition of effective competition even while "considering" them.[7/]

The problem with this argument is that it is a non sequitur. The Commission may, indeed, have the power to weigh the statutory factors differently. It does not follow, however, that the Commission has been given the power to redefine a factor or to dismiss portions of the statutory definition. Rather, the factors are defined specifically by the statute and there is no room in the "effective competition" factor to consider anything but the rates of all systems subject to effective competition.[8/] The Commission's power is limited to considering the impact of the factors relative to each other. Thus, if the Commission believes that the rates for systems subject to effective competition are not an adequate proxy for "reasonable" rates, it must make that determination on the basis of the other statutory factors, not by ignoring the mandatory language of the statute. Of course, as shown by many parties to this proceeding, accounting for all of the factors in the statute, especially the requirement that cable operators be permitted a reasonable profit, would likely result in benchmarks that are quite unlike the current benchmarks.

7/ See Comments of Bell Atlantic, GTE and the NYNEX Telephone Companies (the "Telephone Companies") at 11-13.

8/ This fact is underscored by the statutory language requiring the Commission to consider "the rates for systems, if any, that are subject to effective competition." 47 U.S.C. § 543(b)(2)(C)(i) (emphasis added). This language makes it evident that Congress expected any system subject to effective competition to be included in the regulatory calculus, not just a sample of such systems. This factor is like the franchise fee factor, which requires the Commission to account for all government-imposed costs of providing cable service. 47 U.S.C. § 543(b)(2)(C)(iv). The telephone company argument is akin to suggesting that the Commission should reinterpret the franchise fee factor to permit recovery only of pure franchise fees and not of state and local taxes, even though those taxes are specifically included as a factor to be weighed by the Commission.

II. Eliminating Low-Penetration Systems from the Definition of Effective Competition Would Result in Unreasonably Low Rates.

Even if the Commission could eliminate low-penetration systems from the definition of effective competition, it would be wrong to do so. Eliminating low-penetration systems would distort data on rates for systems subject to effective competition and would result in financial ruin for cable operators across the country. The first consequence would render the Commission's Rules wholly invalid; the second would harm consumers.

A. Eliminating Low-Penetration Systems Would Distort the Commission's Rate Data Analysis.

Eliminating low-penetration systems from the Commission's rate calculations would eliminate useful data from the Commission's analysis. The survey on which rates would be based would be much too small for statistical reliability and the results would be subject to considerable variation. At the same time, the few systems that would remain in the survey almost certainly are not charging long-term equilibrium prices for their services, which vitiates any validity the data might have.

First, it is important to understand the nature of the arguments made by cable opponents. They claim, in essence, that low-penetration systems must be excluded simply because their rates are too high.[2/] They provide no evidence that low-penetration systems make supra-competitive profits, or that they have lower costs than other systems. A group of telephone companies provides a study that purports to show that low-penetration systems are not the types of systems that should be included in rate

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2/ See, e.g., Comments of CFA at 3.

calculations, but proves nothing that is relevant to deciding whether their rates are reasonable.[10/]

The extreme, result-oriented approach of cable opponents is exemplified by their suggestions that it would be reasonable for the Commission simply to exclude all data from low-penetration systems in calculating rates of systems subject to effective competition.[11/] These commenters would have the Commission exclude from its calculations the data for approximately three-fifths of the systems subject to effective competition under the statutory standard. As Tele-Communications, Inc. ("TCI") points out, the number of "competitive" community units that would remain, 46, is far too small a database from which to derive the "proper" rates for in excess of 33,000 community units.[12/] Other vagaries of the database, such as the extensive use of estimation for equipment revenues, would only increase the uncertainty of the results.[13/]

The statistical folly of relying on such a small sample of competitive systems would be compounded by the considerable evidence presented to the Commission that systems in over-built markets are operated at rates that are not compensatory. These

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10/ Comments of the Telephone Companies at 6-7. Assuming the study's analytic and methodological flaws have no effect on the validity of its results, it shows, in essence, that low-penetration systems often are not fully built or are located in communities that are unlikely to have high demand for cable service. In either case, per-subscriber costs are likely to be high, resulting in higher rates.

11/ See, e.g., Comments of CFA at 7; Comments of United States Telephone Association at 3 (low-penetration data "should be accorded no weight").

12/ See also Comments of TCI, Appendix at 32. To put this number in perspective, the eight benchmark tables, which contain literally thousands of data points, would be based on an average of less than six "competitive" systems each if the low-penetration systems were excluded.

13/ Comments of TCI, Appendix at 32.

systems struggle to cover their variable costs, let alone their capital and fixed costs of providing service. This is particularly the case in markets where the municipality operates a competing system, since the municipality need not pay taxes or franchise fees, as even the CFA recognizes.[14/] Of course, there also is considerable, unrebutted evidence that over-built systems almost always operate at a loss, both from the first phase of this proceeding and from the comments on the Further Notice.[15/]

Any rate formulation that relies exclusively or predominately on these unprofitable systems would clearly be contrary to the statutory mandate that cable operators be permitted to make a reasonable profit.[16/] In the end, the Commission cannot adopt the arguments of those parties attempting to justify a rationale for a 28 percent rate reduction if it would require the Commission to deviate from the original definition of effective competition.[17/]

14/ See Comments of CFA at 3-4. CFA's solution is to exclude both low-penetration and municipal-competition systems from the calculations. Id. This approach would base the rates for all cable systems on a sample of 31 community units, or less than one-tenth of one percent of the 33,000 community units. For the reasons discussed above, the Commission simply could not rely on so few observations in setting rates.

15/ See, e.g., Comments of Joint Parties at 10-11; Comments of NCTA at 10-12; Comments of Coalition of Small System Operators at 3-4 (describing study of profitability of over-built systems).

16/ In fact, as currently designed, the benchmarks do not properly account for this factor. See Petition for Reconsideration of Booth American Company et al., MM Dkt. No. 92-266 (filed June 21, 1993) at 10-11. Excluding the rates for low-penetration systems would compound this error.

17/ In addition, as one commenter points out, adopting a rule that excluded the low-penetration systems would appear to be prohibited rulemaking by result. Comments of Arizona Cable Association, et al. at 16-18. Moreover, at this point in the proceeding, with no evidence that the higher rates charged by low-penetration systems are unjustified, the Commission has no rational basis to exclude them.

B. The Rate Reductions that Would Result from the Elimination of Low-Penetration Systems Would Devastate the Cable Industry.

In considering the proposal to eliminate low-penetration systems from its rate determinations, the Commission also must consider the effect of such an action on the cable industry. As the Joint Parties and other commenters described in their comments, the effect of an additional reduction in permissible rates, twice as large as the previous reduction, would be devastating, not just to cable operators, but to the universe of consumers, programmers, equipment suppliers and others touched by the cable industry. The Commission must not allow such a result.

There can be no doubt that the costs would be enormous. In their comments, the Joint Parties described how further rate reductions would eliminate the razor-thin cash flow margins that will remain after the rate regulation decision and impose a negative cash flow on the entire cable industry.[18/] With negative cash flow, the cable industry would be unable to service its debt, and a widespread collapse would be likely.[19/] Indeed, the "10 percent" rate reduction ordered by the Commission results in great reductions in system revenues; further reductions could put many operators out of business.[20/] The effects of further rollbacks would be particularly devastating because they would put operators in technical violation of loan covenants, rendering cable

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18/ Comments of Joint Parties at 14.

19/ Id. at 12-13.

20/ Comments of Arizona Cable Television Association, et al. at 8-10, 12-16. See also Comments of Colony Communications, Inc. et al. at 10-14.

finances especially precarious.[21/] Further mandated rate reductions could well make it impossible for these and other companies to survive.

Moreover, these radical but likely effects of lower rates will be felt far beyond a few owners of cable systems. These effects would be felt by small shareholders in publicly-traded companies, by small communities like Liberty, New York, where cable operators are major employers, by local employees and equipment suppliers and by franchising authorities and other governments that lose franchise fee and tax revenue. Importantly, the effects of draconian rate reductions would be felt by subscribers who would lose access to the diverse and high-quality programming they have come to expect from their cable systems. It is doubtful that the few survivors of a 28 percent rate reduction would have the capital or the courage to risk bankrolling the kinds of programming that have increasingly convinced Americans that they should subscribe to and watch cable television.

III. Conclusion

The Commission should not attempt to redefine "effective competition" for the

useless. Finally, the rate rollbacks that would result from excluding low-penetration systems would devastate the cable industry, with equivalent effects on suppliers, franchising authorities and, most importantly, consumers.

For all of these reasons, the Joint Parties respectfully request the Commission to reject the proposal in the Further Notice and to retain the existing definition of "effective competition" for the purposes of determining regulated cable rates.

Respectfully submitted,

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